Appendix 3

The Council's Annual Minimum Revenue Provision Statement

Statutory Requirements

The Council is required by statute to set aside a minimum revenue provision (MRP) to repay external debt. The calculation of the minimum revenue provision (MRP) is as per the *Local Authority (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414].* In regulation 28, detailed rules were replaced with a simple duty for an authority to make an amount of MRP which it considers to be "prudent".

The broad aim of a prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant. The guidance includes four options (and there are two alternatives under Option three) for the calculation of a prudent provision.

There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial years. There is also no requirement to charge MRP on the Housing Revenue Account share of the CFR.

The legislation recommends that before the start of each financial year the Council prepares a statement of its policy on making MRP in respect of that financial year and submits it to the Full Council for approval.

Policy for calculation of Prudent Provision

The options for the calculation of a Prudent Provision are detailed in appendix 3A to this report. Authorities must always have regard for the guidance and the decision on what is prudent is for the authority to conclude, taking into account detailed local circumstances, including specific project timetables and revenue-earning profiles.

Following a review of the MRP policy from 2016/17 the prudent provision for Supported Borrowing has been calculated on the basis of the expected useful life of the asset on a straight line (equal instalments) basis.

Option 3 (a), asset life method (Unsupported Borrowing)– equal instalment method will continue to be used for unsupported borrowing and specific treatment for PFI Assets and assets held under Finance Leases and long term capital loans.

Supported Borrowing

Up to 2015/16 the regulatory method (Option1) has been used to calculate MRP for debt which is supported by the Government through the RSG system. Following a review of the MRP policy, it was considered that this method of calculation is not the most prudent basis of calculation for the Council. On the basis that it is not in line with the remaining asset life of the assets linked to the borrowing and also not in line with the repayment profile of the Councils existing external debt, resulting in the Council becoming increasingly over borrowed. This position has arisen due to a change in Government policy, replacing supported borrowing approvals with grant funding, together with the Council currently not proposing to undertake any Prudential (unsupported) borrowing.

The new approach for calculating the MRP for the unsupported borrowing is to link the MRP to the average remaining useful life of the assets it was used to finance. This is in accordance with the general principle of achieving a prudent approach set out in the guidance, that MRP charges should reflect the economic benefit the Council gets from using the asset to deliver services over its useful life. This ensures the Council Tax payers are being charged each year in line with asset usage and prevents current taxpayers meeting the cost of future usage or future Council Tax payers being burdened with “debt” and the costs of that debt, relating to assets that are no longer in use.

An analysis of the average remaining asset life of the assets financed from previous supported borrowing, determined the average remaining life to be around 45 years and this has been used as the basis of calculation. An annuity calculation method was considered, which would result in a lower MRP payments in the early years, but increasing year on year. However, this was not consider to be a prudent approach given uncertainties amount the Council’s future finances and not wishing to burden future Council Tax payers with additional costs. As such, a straight line (equal instalments) calculation basis over 45 years has been used. In the short to medium term this will also put the CFR more in line with the level of external borrowing, reducing any over/under borrowing.

Unsupported Borrowing – Asset Life method

For new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed (unsupported borrowing) the MRP has been calculated in accordance with Option 3 Asset Life Method. Option 3 is to make provision over the estimated life of the asset for which the borrowing is undertaken.

Freehold land cannot properly have a life attributed to it, so for the purposes of Option 3 it should be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate may be used for the land.

To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate. For energy efficiency schemes the payback period of scheme is used as the basis for calculating the period over which MRP is calculated.

This method is a straight forward calculation of MRP for unsupported borrowing which calculates MRP based on asset life.

As with option one, provision for debt under Option 3 will normally commence in the financial year following the one in which the expenditure is incurred. But the guidance highlights an important exception to the rule. In the case of a new asset, MRP would not have to be charged until the asset came into service and would begin in the financial year following the one in which the asset became operational. This “MRP holiday” would be perhaps two or three years in the case of major projects, or possibly longer for some complex infrastructure schemes, and could make them more affordable.

The authority can still make voluntary extra provision for MRP in any year.

PFI Assets and assets held under Finance Leases

For assets under on-balance sheet PFI contracts and finance leases, the annual principal payment amount in the PFI or finance lease model is used as the MRP payment amount, with no additional charges above those within the contract.

Long Term Capital Loans

The Council has made available a small number or capital loans to Housing Associations and Village Halls, financed from the Councils balances. The annual repayments of principal amounts are treated as capital receipts and set aside in the Capital Adjustment Account in place of a revenue MRP charge.

Housing Revenue Account MRP

As at 31/03/17 the HRA CFR is £84.6m, this includes the £83.35m transferred to the Council as part of housing self-financing. In managing the HRA debt and considering the HRA business plan there is no mandatory requirement to make provision in the HRA for annual MRP payments. However, the Council will make annual voluntary provision for debt repayment in the HRA based on affordable levels in the HRA against the need for investment and delivering services in the HRA. The annual level of provision will be determined annually as part of the closure of the HRA.

2018/19 Annual MRP Statement

Appendix 3B provides the MRP statement for the 2018/19 financial year.

Capital Receipts set aside

The current regulations, Local Authority (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414] state that the minimum revenue provision is calculated using the previous year’s closing Capital Financing Requirement for supported borrowing.

In 2009/10 Shropshire Council got DCLG approval to allow the new council to voluntarily set aside capital receipts as at 1st April 2009 to reduce the CFR and consequently reduce the MRP charge for 2009/10. This approach was discussed with our Treasury Advisors and External Auditors and was approved by Members in a report to Council in December 2009.

As the extent of new borrowing is not subject to any limitation the sum of capital receipts set aside are still available to support capital expenditure in future years. This will increase the CFR to its previous level and the MRP charge in future years will increase, but not beyond the level had the saving not been generated in 2009/10. Thus the saving in MRP is therefore temporary, albeit very helpful to the short-term financial position.

As the full level of capital receipts set aside were not required to finance capital expenditure between 2009/10 and 2016/17, a balance was retained as set aside as at the end of each financial year to enable a further MRP savings in the following financial years. In the 2018/19 MRP Statement it has been assumed all the capital receipts retained as set aside as at 31 March 2017 to reduce the CFR will be offset by an increase in the CFR in 2017/18 from capital expenditure incurred in 2017/18. In the event that the level of capital expenditure in 2017/18 to be financed from the capital receipts set aside is below the level of capital receipts set aside, it is proposed to retain the balance in capital receipts as set aside in order to achieve a further MRP saving in 2018/19. This will be reported for approval as part of the Capital Outturn report 2017/18.

Appendix 3A: Options for Prudent Provision

Option 1: Regulatory Method (Supported borrowing)
MRP is equal to the amount determined in accordance with the former regulations 28 and 29 of the 2003 Regulations, as if they had not been revoked by the 2008 Regulations. For the purposes of that calculation, the Adjustment A should normally continue to have the value attributed to it by the authority in the financial year 2004-05. However, it would be reasonable for authorities to correct any perceived errors in Adjustment A, if the correction would be in their favour.

Option 2: CFR Method (Supported borrowing)
MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation.

Option 3: Asset Life Method (Unsupported borrowing)
Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the life of the asset. There are two main methods by which this can be achieved, as described below. Under both variations, authorities may in any year make additional voluntary revenue provision, in which case they may make an appropriate reduction in later years' levels of MRP.

(a) Equal instalment method
MRP is the amount given by the following formula:

$$\frac{A - B}{C}$$

Where:
A is the amount of the capital expenditure in respect of the asset financed by borrowing or credit arrangements
B is the total provision made before the current financial year in respect of that expenditure
C is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires.

For the purpose of the above formula in the initial year of making the MRP the variable "C" should be given the maximum values set out in the following table:

Expenditure Type	**Maximum value of "C" in initial year**
Expenditure capitalised by virtue of a direction under s16(2)(b)	"C" equals 20 years
Regulation 25(1)(a) Expenditure on computer programs	"C" equals the value it would have for computer hardware
Regulation 25(1)(b) Loans and grants towards capital expenditure by third parties	"C" equals the estimated life of the assets in relation to which the third party expenditure is incurred
Regulation 25(1)(c) Repayment of grants and loans for capital expenditure	"C" equals 25 years, or the period of the loan, if longer
Regulation 25(1)(d)	"C" equals 20 years

Acquisition of share or loan capital	
Regulation 25(1)(e) Expenditure on works to assets not owned by the authority	“C” equals the estimated life of the assets
Regulation 25(1)(ea) Expenditure on assets for use by others	“C” equals the estimated life of the assets
Regulation 25(1)(f) Payment of levy on Large Scale Voluntary Transfers (LSVTs) of dwellings	“C” equals 25 years

(b) Annuity method
MRP is the principal element for the year of the annuity required to repay over the asset life the amount of capital expenditure financed by borrowing or credit arrangements. The authority should use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during the repayment period (e.g. by the application of capital receipts) should be made as necessary.

Option 4: Depreciation Method (Unsupported borrowing)
MRP is to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment chargeable to the Income and Expenditure Account.

For this purpose standard depreciation accounting procedures should be followed, except in the following respects.

(a) MRP should continue to be made annually until the cumulative amount of such provision is equal to the expenditure originally financed by borrowing or credit arrangements. Thereafter the authority may cease to make MRP.

(b) On disposal of the asset, the charge should continue in accordance with the depreciation schedule as if the disposal had not taken place. But this does not affect the ability to apply capital receipts or other funding sources at any time to repay all or part of the outstanding debt.

(c) Where the percentage of the expenditure on the asset financed by borrowing or credit arrangements is less than 100%, MRP should be equal to the same percentage of the provision required under depreciation accounting.

Appendix 3B: Minimum Revenue Provision Statement 2018/19

	£
<u>Supported Borrowing – Asset Life (45 years)</u>	
General Fund	
Closing CFR 2016/17	203,344,713
Proposed use of capital receipts voluntarily set aside to be applied in 2017/18	5,300,643
	208,645,356
Less LGR (98) Debt	(152,192)
	208,493,164
Less MRP 2017/18	(4,650,336)
CFR for Supported Borrowing MRP Calculation	**203,842,828**
Add back LGR (98) Debt	152,192
Closing CFR 31/03/18 – Supported Borrowing (GF)	**203,995,020**
Housing Revenue Account	
Closing CFR 2016/17	84,594,619
Less MRP 2016/17 (none budgeted as per HRA MRP policy)	(0)
	84,594,619
Closing CFR 31/03/18 – Supported Borrowing (GF&HRA)	**288,589,639**
<u>Unsupported Supported Borrowing – Asset Life (based on individual assets)</u>	
Unsupported Borrowing brought forward	19,987,978
Add profiled prudential borrowing 2017/18	53,426,595
Less MRP – 2017/18	(1,155,740)
Closing CFR 31/03/18 – Unsupported Supported Borrowing	**72,258,833**
Closing CFR (GF&HRA) 31/03/18 – Borrowing Requirement	**360,848,472**
Additional items included:	
Village Hall Loans	297,763
Housing Association Loans	18,442,160
	379,588,395
<u>Summary MRP</u>	
MRP 2018/19 at 45 year life from 2016/17	4,740,531
LGR (98) Debt MRP	32,521
Prudential Borrowing MRP	3,491,070

Total MRP 2018/19	**8,264,122**

N.B. The above excludes the CFR and MRP charges in relation to the on-balance sheet PFI schemes and finance leases.